

Ford Motor Company
IRS APA HEARINGS
February 1, 2005

Ford Experience:

- Ford has entered into a total of seven APAs and has four pending (two with the IRS and two in Europe that do not involve transactions with the U.S.). These APAs involve eight different countries.
- Ford operates primarily in 'normal' high-tax rate countries, and as a result, tax rate arbitrage is generally not relevant to its transfer pricing analyses.
- Ford has chosen to pursue APAs for several key reasons, The APA process:
 - (i) Provides certainty with respect to Transfer Pricing results and, importantly, in a much short period of time than could be expected without an APA.
 - (ii) Gives Ford the opportunity to bring into play at the outset bilateral considerations and the interest and concerns of the countries on both ends of the transactions.
 - (iii) Significantly reduces the effort required during a regular audit to respond to data inquiries, primarily because the data requested during an APA is ordinarily far more focused on relevant matters. Ford's practice is to submit detailed and hopefully complete submissions with its requests for APAs. Data requests during the APA process have been thorough but not particularly onerous.
- Ford has found the APA process to be invaluable and essential in today's practical world of transfer pricing.

Suggestions for Improvements:

1. Global Consistency:

- Ford generally applies its transfer pricing principles and methodologies in a consistent manner around the world. It is surprising how many different views there are of the arm's length result for the same vehicle under the same terms and conditions.
- Ford suggests that every country, but particularly the U.S. (which is the leader in the area of transfer pricing) needs to take a more objective view of transfer pricing. Moreover, it is suggested that the U.S. needs to take into account the fact that a multinational taxpayer like Ford already is spending substantial resources on trying to comply with the many and varied requirements around the world. Particularly in the APA program, it is not appropriate for each government to impose its own idiosyncratic preferences on the taxpayer that result in different methods and results in every country with a consequent increase in the administrative burden imposed on the taxpayer.
- The APA program should give substantial deference to a methodology that has been accepted by other countries. This would apply in situations where the taxpayer has a consistently applied, global transfer pricing methodology. Changes should not be required simply because a transfer pricing economist could make an argument for an alternative approach. Changes should be limited to those that (i) truly have a material impact on the transfer pricing result and (ii) are clearly correct based on objective standards.

2. Negotiating Position:

- In a bilateral APA, the current practice of the IRS APA Program is to develop a suggested 'negotiating position' to be submitted to the tax authorities of the other country. Experience suggests that the negotiating position is not always objective. Often, it is just what the name implies, a beginning negotiating position from which the IRS is prepared to offer some compromise and concessions. Ford believes this is a mistake, and it encourages the other country to take equally aggressive positions from which it too can compromise.
- This real-world scenario is very much like an audit and Tax Court litigation – something the APA process was supposed to replace. Both sides offer up an increasingly extreme position from which they can compromise. The APA Program was not supposed to be like that. It was intended to be a cooperative process in which the taxpayer and both Governments worked jointly to arrive at the correct result.
- Ford recommends that the IRS re-examine its practice of developing a negotiating position. The U.S. should be the leader in trying to move the debate to a higher, more principled level.

Ford Motor Company
IRS APA HEARINGS
February 1, 2005

3. Taxpayer Involvement in Bilateral APAs:

- In most bilateral APAs, the two governments attempt to develop their positions and reach agreement with minimal involvement of the taxpayer. At the end of the government-to-government negotiations, the taxpayer is simply informed of the outcome. The process should not work this way.
- The transfer pricing methodology belongs to the taxpayer. The APA process is voluntary, and the taxpayer should not be left on the side lines while the two governments negotiate in secret.
- The taxpayer has a valid interest in the outcome. Moreover, the taxpayer has a better understanding of the facts and how they affect the transfer pricing results. This is particularly important for large and complex companies like Ford.

4. IRS Resources

- For the APA Program to function correctly, the IRS needs sufficient resources, both in people and in its operating budget. This is not new, however, it can be frustrating for a taxpayer that has paid a user fee and is told that IRS cannot attend a meeting because it has no travel budget. The funds voluntarily provided by taxpayers specifically for the APA program should be available to support the program. Ford would certainly support the IRS' efforts for legislative changes to make this possible.
- At the same time, the IRS could learn to operate somewhat more efficiently. Some examples include, fewer team members traveling to every meeting (detailed minutes could be provided to those not attending); conference call arrangements or video conferences could be used.

Technical Issues:

1. Critical Assumptions:

- Ford does not believe that Critical Assumptions should necessarily include objective standards that would automatically trigger new discussions over the transfer pricing methodologies.
- Ford's business is very volatile and the passenger car market changes often and rapidly. The treatment of this 'market risk' is usually one of the primary issues in an APA. Once the APA has resolved which party bears that risk, the issue should not be re-examined because the market does not move as anticipated. The 'normal' provision in an APA's Critical Assumption that requires the taxpayer to continue to operate its business as it represented it would do, should be adequate in most cases.
- In transfer pricing, far too much time is spent on remote possibilities that could happen. But are very unlikely to in fact happen. Ford does not believe the IRS should attempt to build into the APA process a fail-safe standard that is intended to deal with the unlikely situation but would by its very nature apply to everyone.

2. Guaranteed Results and Market Risk:

- A typical transfer pricing methodology provides for yearend compensating adjustments to ensure that the tested party's results are, in fact, within the determined arm's length range. This is true whether an APA is obtained or not. The IRS has asked whether this 'guaranteed' profit should be viewed as reducing the tested party's risk to such an extent that the required profit target range itself should be reduced.
- The compensating adjustment mechanism is not intended to achieve a reduction of market risk – it is simply a compliance tool to allow the taxpayer to actually achieve the results it has determined to be arm's length. It would not make sense that if we have determined that the tested party's profits at arm's length would be between A and B, and we then agree that the tested party will have results between A and B, that we have somehow reduced the tested party's risks and it now only has to have a profit result that is between A minus to B minus.